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LEGAL ASPECTS OF AIRCRAFT FINANCE

BY DAVID I. JOHNSTON

PART II†

I. LEASING

A. Introduction

IN THE field of aircraft finance as in other fields of business activity in the United States and Canada today, there is a trend towards leasing items of capital equipment instead of purchasing such equipment.¹ Airlines have begun to use the lease as a means of acquiring aircraft, powerplants, spare parts and ground support equipment to expand their fleets and facilities, and at the same time remain competitive under economic conditions which have made the outright purchase of such equipment undesirable or impossible.² There are circumstances which make leasing an attractive proposition to a carrier regardless of whether or not it has funds available to purchase the equipment.³ In recent years, the manufacturers of airframes and engines have offered sufficiently attractive rental terms to make rental as an alternative to ownership worthy of careful consideration by many airlines.⁴

B. Financial Considerations

An important consideration for airlines whose earnings records have not been good and who as a consequence are short of capital is that leasing avoids the investment of funds required in the case of purchase.⁵ Even

† Editors Note: This is Part II of a two part article. Part I appeared in 29 J. Air L. & Com. 161 (1963).

¹ As of October 31, 1962, the Boeing Airplane Company had on lease nine B-720Bs to Northwest, two B-707-120s to Pan-American and five B-707-320Bs to TWA; Lockheed Aircraft Corporation had on lease nine 1049s to Capitol and six L-1049Hs to TIA; Eastern had leased ten B-720s; Northeast had leased six Convair 880s; Swissair had leased four Caravelles from S.A.S. and S.A.S. had leased Convair 990s from Swissair. In addition, a recent survey indicates that Pacific Northern, Slick, Interocean, British West Indian Airways, Air Afrique, Ansett, Air Ceylon and Thai Airways International are among the air carriers currently operating part of their flight equipment under lease arrangements.

² Steadman, *Chattel Leasing—A Vehicle for Capital Expansion*, 14 Bus. Law. 523 (1959):

It has become increasingly difficult for American businessmen to purchase new production and service equipment or to expand their facilities. Rising costs and the inadequate depreciation policies of the federal government's tax program have combined to shrink the corporate capital reservoir which in the past has supplied the funds for these purchases. To escape this capital squeeze, many corporations have begun to lease the equipment they formerly purchased outright. These companies now lease trucks, cars, busses, railroad cars, barges, airplanes, jet engines, machine tools and supermarket fixtures.

³ White, *Equipment Leasing, Some Pros and Cons*, The Controller 332 (July, 1957).

⁴ American Airlines has leased engines for its twenty-five Boeing 720s, fifteen Convair 990s and thirty Electras (including the latter's propellers) from Allison, General Electric and Pratt & Whitney.

⁵ Sundberg, *Air Charter—A Study in Legal Development* 18:

Firstly, problems of financing made the lease a more attractive contract than the purchase. Aircraft sales prices rose rapidly—the cost of new equipment, once computed in thousands, was now computed in millions, and this feature, although caused to some extent by the galloping inflation, was mainly due to the growth of the size of aircraft. The common aircraft of 1930 was an eight-seater Fokker FVII; its

when conditional sales provide credit over an extended period of time, the terms of sale normally require a downpayment and other payments are scheduled at a rate faster than anticipated depreciation in value of the equipment. Through renting, the airline may obtain new equipment while avoiding the necessity of tying up its funds in the ownership of equipment. The airline may then release capital that would otherwise have been frozen. Presumably the released funds could be employed at higher rates of return in other uses than equipment ownership. Under present circumstances in which marginal profits are general among the carriers, an airline management may prefer to lease and use its capital savings for conducting current operations. Leasing is particularly attractive to an airline desiring to expand its operations. It is recognized as a basic economic fact that capital which works, earns. Accelerated capital turnover which results either from the use of more working capital or from turning the same capital over more quickly, increases profits in relation to the shareholders' investment. In addition, the financial position of the lessee airline is usually much stronger when it turns to its bankers for additional funds to bolster its operating capital.

Leasing may be attractive to an airline initiating a new route with previously undetermined load factors or desiring to gain experience on a new type of equipment. It also permits the interchange of equipment among carriers with seasonal peaks. A carrier with a North Atlantic route will need more equipment to take advantage of the summer traffic while an Eastern seaboard carrier with a Florida route will be busiest in winter. The lease will be used on a short term basis to supplement the carrier's normal fleet requirement. The carrier may thus achieve flexibility through leasing.

In periods preceding the introduction of new and more economical types of equipment by the aircraft manufacturers, the lease may be used as a hedge against obsolescence. The risk of obsolescence which is ever present in the aircraft industry is thus shifted to the lessor. A number of engine manufacturers are prepared to offer a guaranteed maintenance charge fixed on an hourly basis in relation to their commitments as lessors. The manufacturer as lessor may carry out maintenance, overhaul and servicing of the powerplant for a fixed hourly charge negotiated with the lessee. In theory at least, the manufacturer should be able to perform this work more economically than the lessee since the manufacturer's personnel have no learning problems and are using fully equipped facilities which are already established. This service can reduce the lessee's own

equivalent one decade later was the DC-3 of some twenty-eight seats and in 1950 the general size was the fifty-seater ship: the DC-4 or the DC-6 or one of the Constellations. And, if expense by itself was no deterrent, it was made so by the post-war currency restrictions. Aircraft production was mainly American, at least as far as economical four-engine equipment was concerned, and had to be paid for in American currency which European nations had the utmost difficulty in finding. Both factors operated towards the preference of paying periodic limited rents rather than huge immediate purchase prices.

Secondly, aviation generally was a feverish activity dependent upon seasonal and short-lived traffic demands which made the need for carrying capacity often not more than temporary. Leases then tended to be more favourable because they could be made to correspond closely to the periods of demand, while purchases left the operator with idle equipment to maintain after the expiration of the traffic flow. Thirdly, the anticipation of future technical developments made operators inclined to postpone expensive purchases until such time as the new constructions were fully developed, and to avoid investments in the meantime by working with leased equipment.

cost accounting problems, eliminate the administration of one entire operation and enable the airline to analyze powerplant operation with a minimum of cost tracing. Definite forecasts of expenses can be made accurately and the risk of introducing a new type of engine into service reduced at least from the financial point of view.

In leasing its equipment, the airline does not become involved in the difficulties of disposing of the used aircraft. This sometimes troublesome problem is left with the manufacturer whose sales staff may be better organized to locate potential customers for the used aircraft than the airline, particularly if it be a local carrier without nation-wide contacts. If the lessor is a manufacturer or manufacturer's subsidiary in the United States, the financing of the transaction may be handled through the manufacturer's bank. The bank will advance money to the manufacturer on its note, receiving the assignment of the lease and rental. The advance may or may not be secured by a chattel mortgage.⁶ In aircraft leasing where new equipment is concerned, the manufacturer or its subsidiary created for that purpose will act as lessor. Usually the lessee is a prime lessee or otherwise the parent guarantees the credit of its subsidiary. In some cases financial organizations have acted as lessors. Trusts also may be established by banks or finance companies to act as lessors.⁷ Another means of financing the manufacture of new equipment under a lease arrangement, would be for the financial institution to enter into a lease with the airline and pay the full purchase price to the manufacturer with or without recourse against the manufacturer depending upon the credit rating of the airline.

In comparison with financing equipment through some form of borrowing, leasing has the advantage that the obligation to pay rent does not have to be shown on the balance sheet. The obligation to pay rent is, of course, definite and unconditional, but it is not necessarily reflected as a liability on the balance sheet.⁸

⁶ Steadman, *supra* note 2, at 538:

Lenders also protect themselves in many instances by obtaining chattel mortgages on the equipment leased. The investor may require that the lease and mortgage contain default and acceleration clauses, in favor of the mortgagee. Such clauses require the lessee or lessor to pay the balance due in full if there is default on the payments, and allow the mortgagee or lessor to proceed immediately to foreclose the mortgage, repossess the chattels, or arrange for their resale. These clauses give the mortgagee investor his greatest protection, but their presence in a lease agreement, especially if there is no covering mortgage, will often reveal the security nature of the whole transaction. If this is a security transaction there is a danger that the lease itself may be considered a chattel mortgage or a conditional sales agreement.

⁷ *How Jets Are Bought and Sold*, Flight International 503 (April 4, 1962):

Just published by Eastern Air Lines, in a notice to stockholders giving details of the proposed merger with American Airlines, is full information about how Eastern's new fleets are being financed.

Ten Boeing 720s, as well as twenty spare engines (to be used interchangeably on the entire fleet of fifteen Boeing 720s operated by Eastern) are under lease from the Prudential Insurance Co. of America at an aggregate annual rental of approximately \$6,420,000. The term of the lease for each aircraft (and its two accompanying spare engines) is for ten years from the delivery date of the aircraft from the manufacturer. Under the terms of the lease, Eastern may be required, at the lessor's option, to purchase the aircraft (with two spare engines each) on expiry of the lease for about \$477,500 each. The first Boeing 720 under lease was delivered from the manufacturer on August 11, 1961, and the tenth and last was delivered on November 13, 1961.

⁸ A Committee on Accounting Procedures of the American Institute of Accountants has commented in Accounting Research Bull. No. 43, published in 1953, as follows:

The Committee believes that material amounts of fixed rental and other liabilities maturing in future years under long-term leases and possible related contingencies

When the use of chattel assets is acquired on leasing programs the lease liability is not shown on the balance sheet as a liability. Of course there is no asset account for the leased equipment on the asset side; however, the asset to liability ratio and income to liability ratio will be higher. These ratios are important to creditors and to shareholders. Thus a lessee may, by leasing, save its regular credit sources for other purposes, and at the same time show a favorable balance sheet and current operating report when the time comes to utilize this credit. The advent of extensive balance sheet footnoting may result in the listing in footnotes of the leasing contracts, but accountants are by no means agreed as to the necessity for this practice. Even if the listing is necessary, the strength of this operating position will still be apparent.⁹

However, long term leases of aircraft usually involve such substantial commitments of funds by the lessee that footnoting is the practice.

Restrictive covenants in equipment trust agreements, mortgages or indentures which prohibit the airline from incurring additional indebtedness or which require certain consents before any further liens or creditors' interests may be attached to corporate assets, may permit the debtor to lease flight equipment from third persons on a short-term basis. In such circumstances, the senior creditor is protected by limitations on term or rental payable under such lease and the debtor retains some flexibility in renting flight equipment to meet seasonal traffic peaks. Although the obligation to pay rental under a long-term lease must be regarded as real liability, since it is not recorded as a debt on the balance sheet, liens are not created on the assets of the corporation as the corporation does not have title to the leased assets.¹⁰ In addition, a number of the major flag carriers which purchased jet equipment under conditional sale, equipment trust and chattel mortgage agreements during the period of 1956-1958 are today bound to maintain specified debt-equity ratios under restrictive covenants, and, thus, it is a matter of importance whether lease commitments are recorded on the balance sheet as debts. Because of the substantial rental required in the lease of modern aircraft equipment, an operator in poor financial health desiring to obtain such equipment on lease may have the same problems in approaching a potential lessor as he may have in purchasing the equipment. Unless the lessee can demonstrate his sufficiency and capability of meeting his lease obligations, it is not likely that any manufacturer or other lessor would entrust to the lessee a four to six million dollar airplane.

are material facts affecting judgement based on the financial statements of a corporation, and that those relying upon financial statements are entitled to know of the existence of such leases and the extent of the obligations thereunder, irrespective of whether the leases are considered to be advantageous or otherwise. Accordingly, where the rentals or other obligations under long-term leases are material in circumstance, the Committee is of the opinion that: a) disclosure should be made in financial statements or in notes thereto of: (1) the amounts of annual rentals to be paid under such leases with some indication of the periods for which they are payable and (2) any other important obligation assumed or guarantee made in connection therewith, b) the above information should be given not only in the year in which the transaction originates but also as long thereafter as the amounts involved are material, and c) in addition, in the year in which the transaction originates, there should appear disclosure of the principal details of any important sale and lease transaction.

⁹ Steadman, *supra* note 2, at 530.

¹⁰ Hunt, Williams and Donaldson, *Basic Business Finance* 85 (1958).

C. Legal Considerations

1. Registration

In Canada, Section 204 of the Air Regulations, 1960,¹¹ sets forth the citizenship requirements which the owner of an aircraft must meet in order to register the aircraft. It is customary for an aircraft to be registered in the name of the actual operator although the aircraft be operated under lease. Interesting registration problems may arise in circumstances in which a Canadian owner desires to lease an aircraft for operation in interstate commerce in the United States by a United States air carrier. A United States air carrier leasing Canadian owned aircraft would be deemed to be the owner of such aircraft for registration purposes provided that the lease agreement contains an option to purchase in favor of the United States carrier which is susceptible of being reasonably exercised.¹²

Although an aircraft be registered in the name of the operator, the problem of tort liability of the title owner of the aircraft may arise in certain jurisdictions in the circumstances of a lease. Until 1948 when Section 524 of the Civil Aeronautics Act was enacted, lease transactions in the United States relating to aircraft were unsatisfactory because the lessor was exposed to the risk that as owner, regardless of negligence, he could be held by a court to be absolutely liable under the laws of some states for damage to persons and property.¹³

2. Security

A lease is a security instrument which in practically all jurisdictions affords maximum protection to the creditor. In Canada under the Bankruptcy Act, 1949, Section 50 thereof allows the lessor to file with the trustee a proof of claim and the rights of the lessor will be respected. We have noted that the lessor of aircraft, aircraft engines, propellers, appliances and spare parts is granted an immediate right of repossession in reorganization proceedings under Section X of the United States Bankruptcy Act. This protection to which reference is made in a preceding Chapter, was introduced by a 1957 amendment to the Act to encourage aircraft financing and while it extends to include the conditional sales vendor, it does not include the chattel mortgagee.

D. Tax Consequences

Under some leasing arrangements tax advantages may be achieved by the lessee. These result from the fact that rental payments may be qualified as a business expense deductible before income taxes in a greater amount and faster than the company as owner of the equipment could charge by way of depreciation for tax purposes. Under certain forms of lease transactions, portions of rental payments may be used to apply against later purchase of the equipment leased, or other purchase options are offered to the user. In this area the laws of Canada and the United States differ considerably, but in both countries there is a real hazard that options to purchase may invalidate the tax deductibility of lease payments on the grounds that the transactions nominally in lease form are in fact purchases.

An attraction of leasing to the lessee may be the conservation of work-

¹¹ P.C. 1954-1821, as amended.

¹² Refer to § 501 of the Federal Aviation Act of 1958 as amended.

¹³ Hines, *Legal Difficulties in Secured Airline Equipment Financing*, 15 J. Air L. & Com. 11 (1948).

ing capital in circumstances when rentals exceed allowable depreciation with respect to the leased equipment. In such circumstances rental expense deductions can be larger and taxes can be decreased correspondingly. If such tax reduction is to be considered as a method of saving capital, it should be borne in mind that under the forty-seven per cent (Canada) and fifty-two per cent (United States) corporate tax rates, the capital saved as a result of the rental deduction will be approximately one-half of the amount paid as rent.

1. *Income Tax Act of Canada*

Section 18 of the Income Tax Act sets out clearly the law respecting lease-option arrangements.¹⁴ The section provides that for tax purposes a lease-option agreement is to be considered (from the point of view of a lessee) as a contract for the purchase of property rather than as a lease arrangement under which rentals would be a deductible as a business expense. The result is that the lessee is considered to be a purchaser who purchases for a deemed capital cost equal to the price fixed in the agreement subject to certain adjustments. Since he is considered to be purchasing the property, the lessee is allowed the same capital cost allowance to which the lessor-vendor is entitled.¹⁵

Section 18 of the Act is not applicable to lease-option arrangements entered into after 1957 in which the amount to be paid upon the exercise of the option is not less than one hundred per cent of the value of the leased equipment at the time the arrangement was entered into, provided, however, that the option must be exercised not more than five years after the date of the arrangement. If the option date is between five and ten years after the date of the arrangement the terminal payment must be not less than seventy-five per cent (if in excess of ten years, not less than sixty per cent) of the value at the date of the arrangement.¹⁶ While the percentage figures in Section 18(4) are not realistic as related to aircraft equipment which has a high obsolescence incidence, nevertheless the legislation accomplishes its purpose which the Canada Tax Service states to be making "certain that conditional sales of property by lease-option or hire-purchase [are] unattractive to tax payers." The section is intended to be a counter-weight to the diminishing balance method of capital cost allowance and renders it unprofitable to the taxpayer to acquire equipment in this manner as compared to the taxpayer who purchases such equipment at the outset and claims capital cost allowance.¹⁷

2. *Internal Revenue Code of 1954 (United States)*

The lessor-owner who leases goods is entitled to a depreciation deduction from its income as an expense pursuant to Section 167 of the Internal Revenue Code of 1954. On the other hand, the lessee is allowed a deduction for rental paid under Section 162(a)(3) of the Code. Under United States tax legislation the lessor who sells the equipment leased must pay a capital gains tax if a profit is realized on the transaction.¹⁸

¹⁴ Section 18(1) & (2) was formerly Section 18(1) & (2) of The 1948 Income Tax Act, as amended 1950, c.40, § 7. The present Section 18 was substituted in 1958, c.32, § 8(1).

¹⁵ Refer to Canada Tax Service, pp. 18-101.

¹⁶ Income Tax Act of Canada, § 18(4).

¹⁷ Section 18 applies to moveable and immoveable property except certain immoveable farm property.

¹⁸ If the income of the lessor was not derived chiefly from rentals and a considerable proportion of its revenue resulted from the resale of leased equipment, then such equipment may

The position of the lessee and the development of tax legislation in the United States with respect to lease-option agreements is described by Steadman as follows:¹⁹

If the rental payments and corresponding rental deductions are greater than the depreciation deduction would be were the lessee to purchase the equipment, the lessee will have less tax liability than if it purchased the equipment. It will have less money tied up in equipment for which it cannot take a current deduction. If the lessee later purchases the equipment, its basis in these assets will be the paid option price. The rentals have already been deducted and cannot be capitalized for deduction again as depreciation expense.

Prior to the passage of the 1954 Code this tax procedure permitted many tax saving arrangements. Before 1954 the only depreciation method which could be used was the straight-line method. If the lessee could rent for a figure higher than the permissible depreciation rate it would benefit by retaining capital and getting full depreciation for whatever capital it expended on its equipment. Of course the lessees did not want to pay high rent over the entire useful life of the equipment. They, therefore, negotiated for options to purchase the equipment after a certain number of years, or options to renew their leases for a period covering the useful life of the equipment at a nominal rental. The later options were granted because the lessee paid the lessor's purchase price for the equipment in the initial term rental payments. Many of these lessors and lessees were really arranging a financing transaction, hoping at the same time to avoid some taxes. Others entering these leasing agreements to procure needed services and to protect their initial expenditures included these options permitting acquisition of the chattel.

The government, however, took a dim view of these leasing transactions. These options, which usually were exercised and resulted in the lessee's ownership of the leased equipment, appeared very much like a form of equity in the leased goods. I.R.C. Section 162(a)(3) provides that acquisition of equity in property by payment of "rentals" will result in disallowance of the rental deductions. Therefore, the government disregarded the transaction's formal nature as a lease and redescribed this equity acquisition as a sale. On this basis the deductions for rental expense were disallowed and the lessee had to capitalize the rent it had paid, and take deductions on the basis of depreciation of this capitalized amount. The lessor then realized gain only on the excess it recovered over its own purchase price, under the installment payment provisions of the Code.

The Internal Revenue Service with a view to placing further restrictions on the taxpayer in the case of a lease containing an option to purchase, enacted Revenue Rule 55-504:²⁰

Section 4.01. It would appear that in the absence of compelling persuasive factors of contrary implication an intent warranting treatment of a transaction for tax purposes as a purchase and sale rather than as a lease or rental agreement may in general be said to exist if, for example, one or more of the following conditions are present: . . .

not be treated as a capital asset but rather as part of inventory and the profit from its sale would be subject to the usual income tax. Reference is made to Griesinger, *Pros and Cons of Leasing Equipment*, 33 Harv. Bus. Rev. 75 (1955).

¹⁹ Steadman, *supra* note 2, at §39.

²⁰ 1955-2 Cum. Bull. 39.

The ruling has the effect of placing the burden of proof upon the taxpayer to show that his agreement is a lease if one or more of the following conditions exist:

- (1) Part of the rental specifically is applied to the purchase price.
- (2) After a stated amount is paid as rental, title to the property passes automatically to the lessee.
- (3) Early rentals are very high, especially in comparison to the option price or the per centage specified in the contract.
- (4) Rental payments materially exceed the fair rental value of the property.
- (5) The indicated option price or the per centage is nominal in amount.
- (6) The option price is relatively small compared to the total amount of rental which will be paid.
- (7) Part of the rental is specifically designated as interest or is readily recognized as an interest charge.
- (8) The total amount of rental paid during the lease, plus the option price, equals the fair market value of the property plus an interest and carrying charge factor.²¹

In conclusion, an airline desiring to enter into a lease with option to purchase for flight equipment should set the price at the market value of the flight equipment at the time of exercise of the option. Rentals should not be credited against the option price. If it is uncertain that the flight equipment will be purchased, the lease should be drafted to clearly indicate that the party had no intent to purchase at the time it entered into the lease. In the event that the party later decides to purchase the equipment, the price should be negotiated and when agreed upon should not be materially less than fair market values.

II. INTERNATIONAL LAW — GENEVA CONVENTION

A. Introduction

The major airlines of Canada and the United States have international routes the maintenance of which requires that a certain proportion of the airlines' equipment be continuously in foreign countries. Such equipment includes spare engines, spare parts, handling equipment and special tools dispersed at depots at various international centers, in addition to the aircraft which make daily flights from country to country and from continent to continent. This situation poses a serious problem to the financial institutions concerned since it is usually difficult to predict the extent to which property rights and security interests in such equipment will be recognized by foreign courts. Until the present, this has been largely regarded as a calculated risk and the practice has been to limit the risk by stipulating in the security instrument as a condition precedent to default that not more than a certain specified number of aircraft and amount of spares can be outside of the country of registration at any one time.

It was the intention of the Legal Committees of the International Civil Aviation Organization and the International Air Transport Association to resolve this problem when, in 1948, the Convention on the International Recognition of Rights in Aircraft, known as the Geneva Convention, was

²¹ Greenfield, *Corporate Benefits in Using the Sale—Leaseback Device*, *The Tax Magazine* 1017 (Nov. 1959).

opened for signature in Geneva, Switzerland.²² The finalization of the Geneva Convention represented the culmination of a work which was first put on an agenda for study as early as 1925. In that year the International Chamber of Commerce established a special commission of experts on private air law at Paris, France. The commission known as CITEJA²³ placed the problem of aircraft mortgages on its agenda on the basis that the "mortgage" was not sufficiently comprehensive to include all types of security transactions and was not recognized in many countries. Initially two separate conventions on "mortgages" and "ownership" respectively were drafted in 1931. By 1944 both manufacturers and airlines had reached the conclusion that an international convention was required to facilitate the financing of aircraft sales and equipment programmes by providing for international recognition of rights in aircraft.²⁴ As a consequence, PICAQ at the meeting in Chicago in 1946 passed a resolution in favor of a convention on the international recognition of aerial mortgages and real securities, and CITEJA held a meeting in Paris shortly thereafter to discuss the combination of its two drafts into one single document. In 1947 the Legal Committees of ICAO and IATA inherited the work previously done by CITEJA and Commission No. 4 of PICAQ and ICAO, first considering the matter at the Brussels meeting. Finally agreement was reached at Geneva in 1948 and the single convention was substantiated in three languages, each of equal authenticity and differing considerably from the original 1931 drafts of CITEJA.²⁵

Under the Convention each member State undertook to recognize rights validly created in the others if such rights were regularly recorded in a public record of the State in which the aircraft is registered. No international standard form of security was established but those forms currently in use in the member States were continued. The priority of interests were to be determined by the law of the flag of the aircraft, except in the case of salvage, where the rule of admiralty practice has been adopted. The Geneva Convention also makes provision for security interests in respect to spare parts. While not requiring a compulsory registration system, the Convention makes such registration a requirement for recognition under the Convention.

B. Ratification

Unfortunately the Geneva Convention has only been ratified by the United States, Mexico, Pakistan, Germany, Brazil, Norway, Sweden, Chile and Argentina. Adherences have been received from Laos, Ecuador and El Salvador. Argentina and Chile made reservations upon executing the Convention because provision had not been made for State fiscal claims to be given priority over registered charges. Mexico ratified the Convention with a reservation to the effect that the priorities referred to in the Con-

²² Calkins, *Creation and International Recognition of Title and Security Rights in Aircraft*, 15 J. Air L. & Com. 156 (1948); also see *Annotated Text of Convention on International Recognition of Rights of Aircraft*, 16 J. Air L. & Com. 70 (1949).

²³ CITEJA prepared drafts of the Warsaw, Rome and Brussels Conventions as an independent body not created through an international convention. In 1947, CITEJA was absorbed by the Legal Bureau of ICAO.

²⁴ Rosevear, *The IATA Position On International Recognition of Rights In Aircraft*, IATA Bull. No. 21 (1955).

²⁵ For historical background of the Geneva Convention refer to CITEJA documents Nos. 22, 73 & 162; and ICAO documents Nos. 4534, 4545, 4546, 4548, 4549, 4551, 4552, 4556, 4568, 4569, 4578, 4635 & 5722.

vention should be subject, within Mexican territory, to the priorities accorded by Mexican laws to fiscal claims and claims arising out of work contracts. The United States notified ICAO on July 1, 1951, that it found the reservation by Mexico unacceptable, the validity of the qualified ratification of the latter country being left in doubt. In view of the limited number of ratifications, the protection afforded by the Convention is limited and certainly is no embarkation on a new era in international aircraft financing as was intended.

There has not been any serious criticism of the Convention as such and the lack of ratifications may be solely due to the hesitation of many governments to surrender property rights in the field of private law to a multilateral agreement.²⁶ Professor A. B. Rosevear, Q.C., who recently retired as Director of the Institute of Air and Space Law at McGill University in Montreal, has expressed the view that the lack of interest by Governments in the Convention arises principally from the fact that the financing of aircraft purchases has not proven as difficult as was forecast by the experts²⁷ and, therefore, the need for the international recognition of rights in aircraft has not become urgent throughout the world:

The Convention is not perfect. Like all international agreements it contains some weaknesses which arise mostly from the fact that compromises had to be made in order to reconcile conflicting points of view. The imperfections of the Geneva Convention are not the main reasons for the lack of interest in the writer's opinion, arises principally from the fact that the financing of aircraft purchases had not proven as difficult as was forecast by the experts and, therefore, the need for the international recognition of rights in aircraft has not become urgent throughout the world. International air carriers are stronger financially than was anticipated and some of them are nationally owned and operated. The covenants to pay, therefore, of many of these carriers have been and are accepted in many instances. This does not mean, however, that a need for the Geneva Convention does not exist and in time the writer believes more governments will wish to take advantage of its provisions.²⁸

In an article published in January 1960,²⁹ Humphreys and Caplan took the view that financiers have only been able to forego the protection afforded by the Geneva Convention by looking to other security in the form of mortgages on general assets and in the form of insurance under the breach of warranty coverage. These writers contend that breach of warranty coverage is rapidly becoming a credit insurance:

It is difficult to say what the results would be if there had been as many ratifications as there were signatures of the 1948 Geneva Convention on the International Recognition of Rights in Aircraft. International aircraft finance would undoubtedly have been simplified and there might not have been such a widespread demand for exaggerated forms of "breach of warranty" coverage. In fact ICAO, when trying to find possible reasons for the paucity of ratifications, gave as one reason that financiers had been able to take the risk of foregoing the protection afforded by the Convention. They have only

²⁶ Doskow, *Transitory Chattels and Stationary Law: A Proposal to Facilitate Secured Financing of Aircraft Employed in International Flight*, 26 J. Air L. & Com. 36 (1959).

²⁷ ICAO Working Paper A.12-WP/35, LE/5, 12/3/59.

²⁸ Rosevear, *supra* note 24, at 65.

²⁹ Humphreys and Caplan, *Aviation Hull Insurance and Aircraft Financing*, J. Bus. L. 51 (Jan. 1960).

been able to do this because they have used other forms of security. One form has been, for example, mortgages on general assets (other than specific aircraft). The other security has undoubtedly been insurance under the breach of warranty coverage.

In the event of loss or damage to the aircraft, the creditor quite naturally wants his investment to be protected. He does not want to wait for the insolvency of the operator before calling upon financial guarantors. In essence there could be nothing simpler than asking for the payment of insurance moneys to the creditor in any event and regardless of whether the operator has inadvertently broken air navigation regulations—and hence might be technically in breach of his hull policy conditions.

This is the simplest type of "breach of warranty" for which cover is granted. It is a short step from this type of cover for the creditor to be granted protection from every conceivable event—and all by means of an endorsement to the hull policy. That step, however, may represent a change from aviation insurance to a limited form of credit insurance.

It is sound commercial practice for the creditor to charge his debtor with the task and cost of providing insurance coverage. But as "breach of warranty" coverage has grown wider and wider, it has become apparent that the whole physical and moral hazard of aircraft operation and even of the financing of the purchase of aircraft can be shifted to the aircraft hull insurer by means of particular "breach of warranty" endorsements.³⁰

Certainly credit insurance facilities offered to the industry both commercially and by government agency, such as the Export Credits Insurance Corporation in Canada, have made possible sales of aircraft equipment in foreign countries which would not otherwise have been possible. Further ratifications of the Convention may result in decreases in credit insurance premiums, a saving which can be passed on to the customer, and eventually the complete elimination of credit insurance coverage in certain areas.

A certain amount of criticism of the Geneva Convention and its usefulness in aircraft finance has originated with proponents of bilateral treaties. In a recent paper, Daskow, an American writing on this subject, has proposed the adoption of a substantive rule of international conflict law to be implemented by bilateral agreement as an alternative to the Geneva Convention.³¹

In substance he contends that "the law of the flag of the aircraft should govern all dealings with the craft, in whatever land, and regardless of what law the parties in the second State consider themselves to be acting under." Thus, the law developed under the Civil Aeronautics Act would apply to all interests in aircraft of United States registry no matter where such interests were created. He suggests that the fact of an aircraft having wings constitutes notice to all persons that it most probably has been dealt with somewhere else.³²

³⁰ *Id.* at 52.

³¹ Daskow, *supra* note 26, at 47.

³² Daskow, *supra* note 26, at 51:

It is believed that this proposal will give a substantial degree of protection to American institutions financing both American and foreign airlines. Our law provides adequate protection to security interests in both aircraft and spare parts. American recognition of foreign rights under this rule will of course rest on application by our courts of the foreign law. But as long as we are advised of this fact and can take whatever steps are necessary under such a law to protect the parties in this country dealing with foreign craft, we will again be the beneficiaries of such

Bayitch considers that the Convention does not reflect general principles applicable to a large number of countries, but instead is dominated by the specific legal traditions of a few countries.³³ He believes that a revision to the Geneva Convention is required and, in addition, that bilateral treaties be explored as useful expedients in international aircraft finance:

The other great need is for introduction of provisions on recognition of security interests in aircraft into bilateral treaties of friendship and commerce or into treaties of aviation, a method equally or even more promising because the participating countries will be cognizant of and responsive to the real needs of the industry, both transporters and financiers, in legal as well as economic terms.³⁴

Despite the various criticisms of the Geneva Convention, it is still the general consensus that the Convention has provided a useful and practical solution for the problem of financing securely fleets of aircraft used in international air services and for the related problem of conflicts of laws which are more pronounced in this field than in most others. The Convention will only become truly operative when further ratifications from the signatory States are received. As a country with an economy largely dependent upon the airplane as a means of transportation, Canada should have been among the first States to establish a central registry for the recording of security interests in aircraft and to ratify the Geneva Convention, but such action is now long overdue.

C. Main Provisions

The main provisions of the Geneva Convention are summarized below with explanatory commentaries where appropriate.³⁵

The object of the Convention is to protect secured rights of property and possession in respect of aircraft in foreign contracting States on the basis of such secured rights having been validly acquired by third parties in accordance with the law of the State in which such aircraft are registered as to nationality.³⁶ The nationality of the third parties holding security interests does not affect the applicability of the Convention and hence the holders of security interests may profit from the privileges extended under

a rule. In practice a foreign jurisdiction which does not recognize rights of the sort created in this country will find itself without any available source of credit here. The burden would then rest upon them to recognize such foreign created rights under their own law, or suffer serious limitations upon their ability to do business here. Furthermore, a rule of law in the foreign jurisdiction which did not recognize security interests would prove a large block against any airlines being financed by American interests. Particularly where the foreign nation has a state-owned or controlled airline would such legislative persuasion be likely to be effective.

³³ Bayitch, *Aircraft Mortgage, A Study on Comparative Law of the Western Hemisphere*, 13 U. Miami L. Rev. 424, 446 (1958).

³⁴ *Ibid.*

³⁵ For further discussion on these provisions of the Geneva Convention see: Bayitch, *Conflict Law in United States Treaties*, 9 Miami L.Q. 125, 127 (1955); Hofstetter, *L'Hypothèque Aérienne* 219 (1950); Honig, *The Legal Status of Aircraft* 78 (1956); Wilberforce, *The International Recognition of Rights in Aircraft*, 2 Int'l L.Q. 421 (1948); Calkins, *Legal Committee of the International Civil Aviation Organization*, 18 Dep't State Bull. 506, 523 (1948); Warner, *PICAO and the Development of Air Law*, 14 J. Air L. & Com. 1 (1947); Garnault, *Le Projet de Convention de L'O.A.C.I. Concernant la Reconnaissance Internationale des Droits sur Aéronefs*, 2 Revue Française de Droit Aérien 1 (1948); Lachford, *Pending Projects of the International Technical Committee of Aerial Legal Experts*, 40 Am. J. Int'l. L. 280 (1946); *Private International Air Law*, 12 Dep't State Bull. 11 (1945); Moore, *Some Principal Aspects of the ICAO Mortgage Convention*, 14 J. Air L. & Com. 531 (1947); Calkins, *supra* note 22.

³⁶ Refer to art. I(ii) of the Convention.

the Convention even if they do not happen to be nationals of the country of registration or of the country in which the aircraft may be located.³⁷

1. *Recognition of Rights*

There has been included in Article I of the Convention an enumeration of rights to be recognized. The reason for such an enumeration was that those drafting the Convention could not find an expression concisely describing security rights in aircraft which would be acceptable to all legal systems. In 1931, CITEJA had agreed upon the words "droit réel" but the English translation of "right in rem" was not considered to be a satisfactory equivalent and resulted in the enumeration of rights as a compromise.³⁸ Article I was agreed upon as follows:

(1) The Contracting States undertake to recognize:

- (a) rights of property in aircraft;
- (b) rights to acquire aircraft by purchase coupled with possession of the aircraft;
- (c) rights to possession of aircraft under leases of six months or more;
- (d) mortgages, hypothèques and similar rights in aircraft which are contractually created as security for payment of an indebtedness; provided that such rights (i) have been constituted in accordance with the law of the Contracting State in which the aircraft was registered as to nationality at the time of their constitution, and (ii) are regularly recorded in a public record of the Contracting State in which the aircraft is registered as to nationality.

The regularity of successive recordings in different Contracting States shall be determined in accordance with the law of the State where the aircraft was registered as to nationality at the time of each recording.

(2) Nothing in this Convention shall prevent the recognition of any rights in aircraft under the law of any Contracting State; but Contracting States shall not admit or recognize any right as taking priority over the rights mentioned in paragraph (1) of this Article.

Thus it can be seen that the protection extended by the Convention would apply to the right of ownership, conditional sale, long term leases, equipment trust arrangements, pledge and "mortgages, hypothèques and similar rights in aircraft." The condition precedent to recognition of such rights is that the same be "contractually created as security for payment of an indebtedness." The words "contractually created" limit the scope of the Convention to security arrangements resulting from agreement between the parties and not by operation of law or judicial decision. On the other hand the Convention is liberal in that no specific kind of indebtedness is required for qualification.

The broad language indicates that as long as there is an indebtedness of whatever origin, it does not matter whether or not it is connected with the specific aircraft, for example, as purchase price, costs of repair or damages. Consequently, the term indebtedness will include any kind of *causa* from a simple debt to a fleet mortgage.³⁹

In order for security interests to qualify for international recognition, such interests must be "constituted in accordance with the law of the Con-

³⁷ Bayitch, *supra* note 33, at 432.

³⁸ Records indicate that another expression "rights relating to aircraft" was also considered in lieu of a restrictive enumeration but rejected as too vague.

³⁹ Bayitch, *supra* note 33, at 433.

tracting State in which the aircraft was registered as to nationality at the time of their constitution."⁴⁰ There is some question as to the nature of the "law of the Contracting State." In the view of Shawcross and Beaumont, the "law of the Contracting State" in this context means the whole of the law, including the rules as to conflicts of laws, so that the law governing a particular transaction might not be the national law of the Contracting State in question.⁴¹ For example, if an aircraft registered in the United States was sold in Germany, the American Courts could take the position that the validity and effect of the sale must be determined by German law. On the other hand, Bayitch⁴² considers that in the absence of clarification by reference to preparatory materials on this point,⁴³ the general rules for the interpretation of treaties apply and indicate that a reference to the law of a country means its substantive law.

Article 1(2) permits a Contracting State that does not, within its own legal system, have a certain security instrument, *e.g.*, chattel mortgage, to recognize the same created in another State. The clause reading "but Contracting States shall not admit or recognize any right as taking priority over the rights mentioned in paragraph (1) of this Article" was added to cover the circumstance of fiscal liens being imposed by certain Latin American countries.

2. Recording

Article II of the Convention reads as follows:

- (1) All recordings relating to a given aircraft must appear in the same record.
- (2) Except as otherwise provided in this Convention, the effects of the recording of any right mentioned in Article I, paragraph (1), with regard to third parties shall be determined according to the law of the Contracting State where it is recorded.
- (3) A Contracting State may prohibit the recording of any right which cannot validly be constituted according to its national law.

The Convention does not create an obligation for Contracting States to maintain a record of rights in aircraft, but Article I(1) (ii) provides that the security interest must be "regularly recorded in a public record of the Contracting State in which the aircraft is registered as to nationality." Thus it can be seen that while there is no obligation for a Contracting State to provide a record, the provision of such record is essential in order to effect recognition.

An interest not recorded cannot qualify for international recognition regardless of whether the lack of recording is due to the fact that the jurisdiction of the aircraft's nationality has no registers for such purposes, or declines to record the interest, or the interest in question need not to be recorded at all.⁴⁴

It is interesting to note that in the CITEJA draft, a provision was made for the maintenance by Contracting States of a standard record and a uniform system of recordation. In Brussels and Geneva, it was agreed that such a requirement was not practical and that each State should be

⁴⁰ Art. I(1) (i).

⁴¹ Shawcross and Beaumont, *Air Law* 461 (2d ed. 1945).

⁴² Bayitch, *supra* note 33, at 434.

⁴³ Document 5722 at 12, 15, 22, 28 & 35 (1948).

⁴⁴ Bayitch, *supra* note 33, at 434.

free to adopt its own system. Although the word "record" is used in the Convention, this may be merely a file or folder as is the case of the Federal Aviation Agency in the United States.

3. *Attachment or Sale of Aircraft in Execution*

In the event of an attachment or a sale of an aircraft in execution:

the Contracting States shall not be obliged to recognize, as against the attaching or executing creditor or against the purchaser, any right mentioned in Article I, paragraph (1), or the transfer of any such right, if constituted or effected with knowledge of the sale or execution proceedings by the person against whom the proceedings are directed.⁴⁵

A sale in execution cannot be made unless: "all rights having priority over the claim of the executing creditor in accordance with this Convention which are established before the competent authority, are covered by the proceeds of sale or assumed by the purchaser."⁴⁶ The proceedings for the sale of an aircraft in execution shall be determined by the law of the Contracting State where the sale takes place, any such sale being subject to the following formalities:

(1) The date and place of the sale shall be fixed at least six weeks in advance.⁴⁷

(2) The executing creditor shall supply to the Court or other competent authority a certified extract of the recordings concerning the aircraft.⁴⁸

(3) The executing creditor shall give public notice of the sale at the place where the aircraft is registered as to nationality, in accordance with the law there applicable, at least one month before the day fixed.⁴⁹

(4) Concurrently with (3) above, the executing creditor shall notify by registered letter (air mail if possible) the recorded owner and the holders of recorded rights in the aircraft and of rights noted under Article IV(3) of the Convention, according to their addresses as shown on the record.

(5) Costs legally chargeable under the law of the Contracting State where the sale occurs, incurred in the common interest of creditors in the course of execution proceedings leading to the sale, shall be paid out of the proceeds of sale before any claims, including those given preference by Article IV of the Convention.⁵⁰

The sale of an aircraft in execution in conformity with formalities listed in (1) to (5) above has the effect of transferring the property in such aircraft free from all rights which are not assumed by the purchaser.⁵¹

4. *Aircraft and Spare Parts as Security*

The Convention does not include a specific definition of "aircraft," but Article XVI thereof provides that the term "aircraft" for purposes of the Convention shall include "the airframe, engines, propellers, radio apparatus, and all other articles intended for use in the aircraft whether installed therein or temporarily separated therefrom." Government owned

⁴⁵ Art. VI.

⁴⁶ Art. VII(4).

⁴⁷ Art. VII(1).

⁴⁸ Art. VII(2)(a).

⁴⁹ Art. VII(2)(b).

⁵⁰ Art. VII(6).

⁵¹ Art. VIII.

aircraft fall under the terms of the Convention unless they be employed for military, customs or police service.⁵²

Article X(4) does however define "spare parts":

For the purpose of this Article the term "spare parts" means parts of aircraft, engines, propellers, radio apparatus, instruments, appliances, furnishings, parts of any of the foregoing, and generally any other articles of whatever description maintained for installation in aircraft in substitution for parts or articles removed.

In some States, spare parts may be used as security per se but the Convention prohibits recognition of independent security interests in spare parts. The existence of security interests in spare parts related to aircraft are only accepted to the extent that they exist in accordance with the applicable law of the Contracting State affected.⁵³ Spare parts in this context would presumably be those defined as such by the Convention and would not include other types for which provision may be made under the law of such Contracting State.

Bayitch has pointed out that the requirements of the Convention in respect of spare parts exceed in certain respects the provisions of the most sophisticated national legal systems in this area.⁵⁴ Such requirements are contained in Article X(1) and (2) of the Convention reading as follows:

(1) If a recorded right in an aircraft of the nature specified in Article I, and held as security for the payment of an indebtedness, extends, in conformity with the law of the Contracting State where the aircraft is registered, to spare parts stored in a specified place or places, such right shall be recognized by all Contracting States, as long as the spare parts remain in the place or places specified, provided that an appropriate public notice, specifying the description of the right, the name and address of the holder of this right and the record in which such right is recorded, is exhibited at the place where the spare parts are located, so as to give due notification to third parties that such spare parts are encumbered.

(2) A statement indicating the character and the approximate number of such spare parts shall be annexed to or included in the recorded document. Such parts may be replaced by similar parts without affecting the right of the creditor.

In summary, it can be said that the Convention of the International Recognition of Rights in Aircraft, 1948, represents an unprecedented departure into a complex area of international private law without there being revealed to date, in the opinion of the writer, any serious technical difficulties or omissions. The signatory States should advance the cause of international aircraft financing by ratifying the Convention as soon as possible, leaving aside all questions of modifications, refinements and alternatives until the existing agreement has been shown to be defective or deficient in the form in which it has been adopted.

III. PRIORITIES OF LIENS AND PRIVILEGES

The subject of priorities of secured interests has been included herein for reference purposes to serve as an outline and point of departure for the aviation law practitioner faced with a problem in this field. While the

⁵² Art. XIII.

⁵³ Art. X(1).

⁵⁴ Bayitch, *supra* note 33, at 435.

scope of this work precludes a definitive treatment of this complex area of the law, it was considered that a general outline of statutory material and judicial precedent in the field would be useful. Reference will be made to the common law and the Geneva Convention, 1948.

A. Common Law

Since the rank of aircraft liens is a relatively new consideration, both the courts and legislators have referred to two traditional sources of priority law for precedent, namely the common law and maritime law.

The common law has furnished two principles of note, the time-right doctrine of "*qui prior est tempore potior est jure*"⁵⁵ and the "common law" lien belonging to the artisan. Courts have commonly preferred the latter before all other liens, including in certain cases antecedent statutory liens. However, maritime law has traditionally determined the priority of maritime liens in the inverse order of time accrual with the most recent lien taking precedence over all earlier liens. Superimposed upon this doctrine is a system of ranking liens by class.⁵⁶ Maritime liens have been determined by admiralty decisions to outrank generally non-maritime claims and, in the United States, perfected mortgages while junior in rank to all earlier liens, outrank most subsequent maritime liens.⁵⁷

Liens affecting aircraft under the common law system are recognized to include the following:

(a) Secured financing devices such as the mortgage, conditional sale and equipment trust.⁵⁸

(b) Government penalty liens giving rise to rights in rem against the aircraft for non-compliance with governmental regulations in respect of aviation⁵⁹ or customs.⁶⁰

(c) Government tax liens for unpaid taxes.⁶¹

(d) Liens resulting from torts for collision or ground damage under certain circumstances.⁶²

(e) Liens for wages may be recognized by courts on the same basis as the lien of the seaman for wages under maritime law.⁶³

(f) Repairman's lien for the contract price of the work or the reasonable value of the artisan's services.⁶⁴

(g) Storage lien for the storage and safekeeping of aircraft has been enacted by a number of state legislatures in the United States.⁶⁵

⁵⁵ He who is prior in time is prior in right.

⁵⁶ The *William Leishear*, 21 F.2d 862, 863 (D.C. Md. 1927):

to-day it is possible to deduce, from the decisions, the following order of priority, existing irrespective of time, which represents the weight of authority: (1) seaman's wages; (2) salvage; (3) tort and collision liens; (4) repairs, supplies, towage, wharfage, pilotage, and other necessities; . . . (6) non-maritime claims.

⁵⁷ Scott, *Liens in Aircraft: Priorities*, 25 J. Air L. & Com. 193, 197 (1958).

⁵⁸ 52 Stat. 1006 (1938); 49 U.S.C. § 523(c) (1952).

⁵⁹ 52 Stat. 1017 (1938); 49 U.S.C. § 523 (1952).

⁶⁰ 66 Stat. 203 (1952); 8 U.S.C. § 1229 (1952).

⁶¹ 53 Stat. 448-49 (1953); 26 U.S.C. § 3670-2 (1954).

⁶² Del. Code Ann. (1953) ch. (a) § 305; Vt. Stats. § 5304 (1947).

⁶³ *Greer v. Davis Air Lines, Inc.*, 1930 U.S. Av. 302 (Georgia, Municipal Court of Atlanta, Oct. 17, 1930).

⁶⁴ *Modern Air Transport, Inc. v. Pacific Airmotive Corp.*, 20 N.J. Super. 609, 90 A.2d 108 (1952). Court held that in order to qualify for a lien upon an aircraft, services must have been performed thereon and not on an aircraft part which is subsequently installed on the aircraft. Also refer to *Jones v. Bodkin*, 172 Okla. 38, 44 P.2d 38 (1935).

⁶⁵ Ala. Code Ann. (1940) Title 4, § 29; Ark. Stat. Ann. (1947) § 74-605; N.Y. Consol. Stat. (1940) Lien Law § 184.

Before considering the question of seniority between vendors or holders of security interests and subsequent lien claimants, it may be helpful to review the meaning and effect of the federal recordation statute first enacted by the United States Congress in 1938 as Section 503 of the Civil Aeronautics Act.⁶⁶ The effect of this statute has been concisely described as follows:

While the court⁶⁷ is undoubtedly correct that Congress may establish the priority of its liens with respect to liens asserted by private individuals under state statutes or by virtue of common law, one may seriously question whether it intended to do so in this instance. The purpose of the statute was reportedly to eliminate confusion engendered by a multitude of state recording systems by providing a single basis for constructive notice, not to establish the priority of a recorded security interest over all subsequent claims. The only situation in which priority appears to be determined by operation of the statute is where the security holder has failed to record his interest. Such failure invalidates the conveyance as to innocent third persons. But recordation itself merely validates; it does not grant priority. Certainly there is much respectable authority in this country preferring the lien of the artisan to that of the antecedent holder of a recorded security, either on a theory of implied consent or agency. There is no indication that Congress intended to overrule such authority by passing Section 503.⁶⁸

It is concluded that the federal recordation statute in the United States does not purport to affect the existing priority doctrines by its provisions, this thesis being further substantiated in *United States v. United Aircraft Corporation*.⁶⁹

The problem of interest to financial institutions with aviation investments concerns the rank of a recorded security interest vis-a-vis a subsequent lien. The present situation under the laws of the United States is as follows:⁷⁰

(1) Status of debtor—The security instrument binds the purchaser or borrower, their assigns and persons with actual notice of the transaction whether or not recording takes place.⁷¹

(2) Status of subsequent purchasers—If the security instrument has been recorded the title of the security holder will prevail over that of subsequent purchasers. In *Dawson v. General Discount Corp.*⁷² the right asserted by the subsequent claimant was that of title based upon a sale from the original borrower or mortgagor. The Court held that the right of the original mortgagee who retained title and caused the same to be recorded with the FAA, would prevail in spite of there being no actual notice to the subsequent purchaser.

(3) Status of subsequent attaching creditors—Although the jurisprudence is not uniform, probably the best view is that the title of the security holder who has recorded his interest will prevail against a subsequent attaching creditor on the basis of constructive notice.⁷³

⁶⁶ Now the Federal Aviation Act, 1958.

⁶⁷ *In re Veteran's Air Express Co.*, 76 F. Supp. 684, 691 (D.C.N.J. 1948).

⁶⁸ Scott, *supra* note 57, at 203.

⁶⁹ 80 F. Supp. 52 (D.C. Conn. 1948).

⁷⁰ Scott, *supra* note 57, at 204.

⁷¹ *Bishop v. R.S. Evans East Point, Inc.*, 80 Ga. App. 324, 56 S.E.2d 134 (1949). Held that failure to record under Section 503 does not void a conveyance as between buyer and seller.

⁷² 82 Ga. App. 29, 60 S.E.2d 653 (1950).

⁷³ *Wilson v. Barnes*, 359 Mo. 352, 221 S.W.2d 731 (1949).

(4) Status of subsequent repairmen—If the subsequent claim is based upon a lien for repairs, the court decisions are less clear. In *Anderson v. Triair Associates, Inc.*⁷⁴ and in *Boise Flying Service v. G.M.A.C.*,⁷⁵ the subsequent repairman's lien was preferred notwithstanding constructive notice through recording. On the other hand, *Atlas Securities Co. v. Ramsey*⁷⁶ represents the view that the antecedent security-holder is to be preferred provided that his interest has been properly recorded. Scott points out that the statute law on this point is not consistent and concludes by proposing the introduction of the following extract from the Uniform Commercial Code into the Federal Aviation Act, 1958, in lieu of subdivision (g) of Section 503 thereof:

When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.⁷⁷

The effect of the amendment would be to prefer the lien of the repairman in all cases where local statute does not declare otherwise. While there is no doubt but that such a provision would assist the individual repairmen and small servicing centers throughout the country whose business concerns light aircraft and who find it impractical to search the FAA records each time work is to be done on an aircraft, nevertheless a large maintenance depot repairing, maintaining and servicing a fleet of turbo-prop or jet aircraft could establish substantial claims by virtue of such a change in the law, to the detriment of prior security holders. The risks of financial institutions engaged in aircraft finance are considerable and careful consideration must be given to any legislation which could impair in any way their position as security holders.

In summarizing the laws of the United States in this subject, Scott⁷⁸ considers that the system of priority that appears best to represent existing authority would be as follows: (1) court costs; (2) storage, materialmen's and repairmen's liens; (3) recorded security interests; (4) government tax and penalty liens; (5) unrecorded security interests. Between liens of the same class, priority would be decided on the time-right basis. The author questions whether categories (2) and (3) above should not be reversed and, in view of conflicting decisions on point, this will remain a close question.

B. Geneva Convention, 1948

The Convention has eliminated a number of claims which would normally be considered privileged under national laws. The apparent priority of liens and privileged claims is as follows:

1. Cost of Sale

Article VII(6) provides as follows:

Costs legally chargeable under the law of the Contracting State where the sale takes place, which are incurred in the common interest of creditors in the

⁷⁴ 149 U.S. Av. 440 (C.C. Wis. 1947).

⁷⁵ 56 Ida. 5, 36 P.2d 813 (1934).

⁷⁶ 262 Ill. App. 559 (1931).

⁷⁷ Uniform Commercial Code, § 9-310 (1952).

⁷⁸ Scott, *supra* note 57, at 215; Also refer to Dykstra and Dykstra, *The Business Law of Aviation* 477 (1946).

course of execution proceedings leading to sale, shall be paid out of the proceeds of sale before any claims, including those given preference by Article IV.

It is interesting to note that in order to qualify, the costs must be incurred in the common interest of creditors.

2. *Salvage and Preservation*

Article IV provides as follows:

(1) In the event that any claims in respect of:

- (a) compensation due for salvage of the aircraft, or
- (b) extraordinary expenses indispensable for the preservation of the aircraft,

give rise, under the law of the Contracting State where the operations of salvage or preservation were terminated, to a right conferring a charge against the aircraft, such right shall be recognized by Contracting States and shall take priority over all other rights in the aircraft.

(2) The rights enumerated in paragraph (1) shall be satisfied in the inverse order of the dates of the incidents in connection with which they have arisen.

(3) Any of the said rights may, within three months from the date of the termination of the salvage or preservation operations, be noted on the record.

(4) The said rights shall not be recognized in other Contracting States after expiration of the three months mentioned in paragraph (3) unless, within this period,

- (a) the right has been noted on the record in conformity with paragraph (3), and
- (b) the amount has been agreed upon or judicial action on the right has been commenced. As far as judicial action is concerned, the law of the forum shall determine the contingencies upon which the three months period may be interrupted or suspended.

(5) This Article shall apply notwithstanding the provisions of Article I, paragraph (2).

Compensation for salvage and preservation expenses must be privileged under the law of the jurisdiction where the operations of salvage or preservation were terminated in order to qualify, in addition to such expenses constituting a lien on the aircraft under the same law. The rank of such privileged claims *inter se* shall be "satisfied in the inverse order of dates of the incidents with which they have arisen," this principle having been adopted from the maritime law.⁷⁹ Recognition of rights so acquired will cease upon failure to record the same within a three month period.

3. *Claims Arising From Damage to Persons on Ground*

When damage or injury is caused to persons or property on the surface of the Contracting State where the execution sale takes place by an aircraft subject to a security right under Article I of the Convention, unless adequate insurance shall have been provided, the national law of such state may provide, among other things, in the event of seizure of the offending aircraft:

that any right referred to in Article I held as security for an indebtedness encumbering the aircraft may not be set up against any person suffering

⁷⁹ The basis of the maritime law theory giving precedence to the most recent lien is twofold: (i) each lienor acquires an interest in the ship and accepts the risk of the ship being subjected to additional liens as it continues its voyage, and (ii) the last lienor in allowing the ship to continue such voyage benefits the prior lienors and thus ranks senior to them.

such injury or damage or his representative in excess of an amount equal to eighty per cent of the sale price.⁸⁰

4. *Rights Recognized Under Article I*

Article I provides as follows:

(1) The Contracting States undertake to recognize:

- (a) rights of property in aircraft;
- (b) rights to acquire aircraft by purchase coupled with possession of the aircraft;
- (c) rights to possession of aircraft under leases of six months or more;
- (d) mortgages, hypothèques and similar rights in aircraft which are contractually created as security for payment of an indebtedness; provided that such rights
 - (i) have been constituted in accordance with the law of the Contracting State in which the aircraft was registered as to nationality at the time of their constitution, and
 - (ii) are legally recorded in a public record of the Contracting State in which the aircraft is registered as to nationality.

The regularity of successive recordings in different Contracting States shall be determined in accordance with the law of the State where the aircraft was registered as to nationality at the time of each recording.

(2) Nothing in this Convention shall prevent the recognition of any rights in aircraft under the law of any Contracting State; but Contracting States shall not admit or recognise any right as taking priority over the rights mentioned in paragraph (1) of this Article.

The provisions of Article V of the Convention should be read in conjunction with Article I above:

The priority of a right mentioned in Article I, paragraph (1) (d), extends to all sums thereby secured. However, the amount of interest included shall not exceed that accrued during the three years prior to the execution proceedings together with that accrued during the execution proceedings.

The reference in the first sentence thereof to "all sums thereby secured" would include the cost of insurance as part of the total indebtedness. The second sentence thereof makes specific provision for securing the interest included in such indebtedness.

5. *Other Rights*

The priority of other interests *inter se* would appear to be ranked according to their status under the national law of the aircraft.

The qualification "but Contracting States shall not admit or recognize any right as taking priority over the rights mentioned in paragraph (1) of this Article" was added to Article I(2) in the course of negotiations to allow certain Latin American States to impose fiscal claims which would rank immediately after the rights mentioned in Article I(1) and senior to other subsequent rights.

IV. LEGISLATION FOR CANADA—ESTABLISHMENT OF CANADIAN REGISTRY FOR RIGHTS IN AIRCRAFT

A. *Need For Legislation*

As the field of air transport continues to expand in Canada, the difficulties and complications involved in financing aircraft purchases will

⁸⁰ Art. VII(f) (b).

surely become more acute due to the lack of a central registry for the recording of title to and encumbrances against Canadian civil aircraft. Air Regulations⁸¹ under the Aeronautics Act of Canada⁸² provide for the registration of Canadian civil aircraft in the name of the "owner" but the "owner" is defined to include the person in possession of the aircraft as operator. The name of the person holding security interests in the aircraft does not appear in the register. Subsection (55) of Section 101 of the Air Regulations defines "owner" with reference to an aircraft to include:

- (a) the person in whose name the aircraft is registered,
- (b) a person in possession of the aircraft as purchaser under a conditional sale or hire-purchase agreement that reserves to the vendor the title to the aircraft until payment of the purchase price or the performance of certain conditions,
- (c) a person in possession of the aircraft as chattel mortgagor under a chattel mortgage, and
- (d) a person in possession of the aircraft under a bona-fide lease or agreement of hire.

Furthermore, Section 205 thereof provides as follows:

Notwithstanding anything in this Part, an aircraft that is the subject of:

- (a) a chattel mortgage, or
- (b) a conditional sale or hire-purchase agreement that reserves to the vendor the title to the aircraft until payment in full of the purchase price or the satisfaction of some other condition,

may be registered in the name of the mortgagor or purchaser as owner of the aircraft if such mortgagor or purchaser is qualified under Section 204 to be the registered owner of a Canadian aircraft and the Minister is satisfied that it is in the public interest so to do.

Thus, a prospective purchaser of an aircraft or an investor financing such a purchase cannot determine the actual owner or holder of security interests from the existing aircraft register which was never intended to fulfill such a function. It has been seen that aircraft are financed by conditional sales, chattel mortgages, equipment trusts or sometimes by lien notes. However, there is little uniformity between the treatment of these security devices by the laws of each of the provinces. Not only do the substantive laws differ in many cases but there is no uniformity in respect of recording requirements. In point of fact, in Quebec the law generally makes no provision for the registration of title to or charges against moveable property, except in circumstances in which such property constitutes security subject to a trust deed.⁸³ In some provinces the validity of a lien note is dependent upon registration while in other provinces such is not the case.

The chattel mortgage is probably the most commonly used security device in the aircraft finance, but the laws of the Province of Quebec do not recognize the chattel mortgage. In provinces other than the Quebec, the Chattel Mortgage Acts usually require that the chattel mortgage be registered in a county court and it is effective only in the county court district where the mortgaged property is located. Such registration requirements render the chattel mortgage practically useless in its applica-

⁸¹ P.C. 1960-1775.

⁸² R.S.C. 1952, c. 3 § 1.

⁸³ Special Corporate Powers Act, R.S.Q. ch. 280 (1941).

tion to so mobile a chattel as an aircraft. In recognition of this problem, Alberta has already established a provincial registry for security rights in aircraft. The prospective purchaser however should extend his title search to other provinces if there is reason to believe that the aircraft may have been operated outside the province in which the sale is to be effected.

In view of the difficulty and in some cases impossibility of establishing with a reasonable degree of certainty the persons holding security interests in a Canadian civil aircraft, the advantages of the creation of a central registry for the recordation of rights in aircraft are obvious. Nor are these advantages limited geographically to Canada. The establishment of the registry will enable Canada to ratify the Convention on the International Recognition of Rights in Aircraft to which Canada was a signatory in Geneva in 1948. Financial institutions and others having security interests in Canadian aircraft flying on international routes outside of Canada would then be able to avail themselves of the protection offered by the Geneva Convention. It has been noted that the Geneva Convention of 1948, does not expressly oblige a Contracting State to provide a public record for the recordation of security interests but the provision of such a record is essential in order for the States to comply with their respective obligations to recognize the rights set forth in Article 1(1)(a) to (d) of the Convention.

The development of the Canadian nation has, over the past forty years, been in large part dependent upon the airplane as a tool of transportation. The role of the airplane in extending the frontiers of Canada has been of national importance from the days of early bush flying to the present time. The use of mass air transport in the Canadian North was best illustrated by the Dew Line construction and supply operation. With the airplane a part of Canada's history and inevitably a part of her future, there should be no hesitation or delay on behalf of Parliament to implement the proposed legislation and to ratify the Geneva Convention in order to facilitate the financing of aircraft. The security of the investor would thus be effectively increased and the interest rates charged in aircraft financing should accordingly be reduced. It is likely also that as more States ratify the Geneva Convention, the premiums paid by exporters for credit insurance could be reduced and this saving also passed on to the aircraft operator.

The Congress of the United States established a central registry for the recordation of rights in aircraft in 1938, and the registry has since that time fulfilled its function usefully and effectively.

B. Jurisdiction Of Parliament Of Canada

The enactment of legislation by the Parliament of Canada to provide for the creation of the proposed central registry for security interests in aircraft would be intra-vires the general power of Parliament "to make laws for the peace, order, and good government of Canada . . ." pursuant to Section 91 of the British North America Act. The object of such legislation would be to make compulsory the registration of security interests in aircraft in a public record to be administered by the Department of Transport. The constitutional cases to which reference is made below support the position that the enactment of such legislation is within the jurisdiction of the Parliament of Canada,

In the *Johanneson* case,⁸⁴ Rinfret, C. J., affirmed the application of the decision of the Privy Council in the *Aeronautics* case.⁸⁵

Notwithstanding that the International Convention under consideration in the *Aeronautics* case, was denounced by the Government of Canada as of April 4, 1947, I entertain no doubt that the decision of the Judicial Committee is in its pith and substance that the whole field of aerial transportation comes under the jurisdiction of the Dominion Parliament. In the language of their Lordships at p. 77: "Aerial navigation is a class of subject which has attained such dimensions as to affect the body politic of the Dominion."

At page 304 of the same report, Kerwin, J., clearly set forth his views:

Now, even at the date of the *Aeronautics* case, the Judicial Committee was influenced (*i.e.* in the determination of the main point) by the fact that in their opinion the subject matter of air navigation was a matter of national interest and importance and had attained such dimensions. . . . It is with reference to this phase of the matter that Viscount Simon's remarks in *A.-G. Ontario v. Canada Temperance Federation*, (1946), 2 D.L.R. at p. 5, A.C. at p. 205, 85 Can. C.C. at pp. 229-30, must be read. What was there under consideration was the Canada Temperance Act, originally enacted in 1878, and Viscount Simon stated: "In their Lordships' opinion, the true test must be found in the real subject matter of the legislation: if it is such that it goes beyond local or provincial concern or interests and must from its inherent nature be the concern of the Dominion as a whole (as for example in the *Aeronautics* case . . . and the *Radio* case . . .), then it will fall within the competence of the Dominion Parliament as a matter affecting the peace, order and good government of Canada, though it may in another aspect touch upon matters specially reserved to the Provincial Legislatures." This statement is significant because, while not stating that the *Aeronautics* case was a decision on the point, it is a confirmation of the fact that the Board in the *Aeronautics* case considered that the subject of aeronautics transcended provincial legislative boundaries.

Kellock, J., emphasized the extent to which the jurisdiction of Parliament prevailed in the *Johanneson* case at page 311:

Once the decision is made that a matter is of national interest and importance, so as to fall within the peace, order and good government clause, the provinces cease to have any legislative jurisdiction with regard thereto and the Dominion jurisdiction is exclusive. If jurisdiction can be said to exist in the Dominion with respect to any matter under such clause, that statement can only be made because of the fact that such matters no longer come within the classes of subjects assigned to the provinces. I think, therefore, that as the matters attempted to be dealt with by the provincial legislation here in question are matters inseparable from the field of aerial navigation, the exclusive jurisdiction of Parliament extends thereto.

Estey, J., in the same report at page 317, quoted with approval from the Privy Council decision in the *Aeronautics* case:

There may be a small portion of the field which is not by virtue of specific words in the B.N.A. Act vested in the Dominion; but neither is it vested by specific words in the Provinces. As to such small portion it appears to the Board that it must necessarily belong to the Dominion under its power to make laws for the peace, order and good government of Canada. Further,

⁸⁴ *Johanneson v. Rural Municipality of West St. Paul*, 1 S.C.R. 292, 302 (1952).

⁸⁵ *In re The Regulation and Control of Aeronautics in Canada*, (1932) A.C. 54 (Can.).

their Lordships are influenced by the facts that the subject of aerial navigation and the fulfillment of Canadian obligations under Section 132 are matters of national interest and importance; and that aerial navigation is a class of subject which has attained such dimensions as to affect the body politic of the Dominion.

In a decision of the British Columbia Court of Appeal in 1959,⁸⁶ the jurisdiction of the Parliament of Canada in the matter of aeronautics was again upheld. The appellant had submitted that the Aeronautics Act and regulations enacted pursuant thereto were ultra vires of the Parliament of Canada in so far as they presume to regulate and control the operation of aircraft operating solely within a province. Coady, J. A., delivered the judgment of the court:

It is clear that effect cannot be given to this submission. The jurisdiction of the federal Parliament is concluded by the judgments in the following cases: *In re Regulation and Control of Aeronautics in Canada*; *In re By-Law 292 West St. Paul R.M.*; *Johanneson v. West St. Paul R.M.* It follows therefore that the Act and the regulations in issue here are intra vires and this submission of the appellant must be rejected.

Professor Rosevear of the Institute of Air and Space Law at McGill University has made reference⁸⁷ to judgments in certain railway cases which through analogy may be cited in support of the opinion that the Parliament of Canada possesses exclusive jurisdiction over almost all aspects of civil aviation:

By way of analogy, I wish to refer also to the case of *Attorney General of Canada v. C.P.R. and C.N.R.*:⁸⁸ "That Parliament, competent to provide for the acquisition of land for a railway and to limit by conditions the extent of acquisition, cannot also provide the reasonable means for insuring that limitation, would, in the particular circumstances, expose the substantive power to virtual nullification. Powers in relation to matters normally within the provincial field, especially of property and civil rights, are inseparable from a number of the specific heads of Section 91 under which scarcely a step could be taken that did not involve them. In each such case the question is primarily not how far Parliament can trench on Section 92 but rather to what extent are property and civil rights within the scope of the paramount power of Parliament."

Another relevant case is that of *C.N.R. et al and C.P.R. et al v. Attorney General of Saskatchewan*⁸⁹ in which the question arose as to whether various Saskatchewan labour acts applied to inter-provincial railway companies. In his judgment Macdonald, J. A., made the following statement: "For it must not be overlooked that a constitution is being construed, and the expressions used should in my opinion receive a broad, liberal interpretation that will effectuate the intention of Parliament. In this view the employees of the plaintiffs are under the exclusive legislative jurisdiction of the Parliament of Canada, and the provincial acts in question cannot affect them."

The cases to which I have referred⁹⁰ establish that the Parliament of Canada has jurisdiction over almost all aspects of civil aviation. There may be some

⁸⁶ *Jorgenson v. Pool*, 28 W.W.R. 265, 124 Can. C.C. 39 (1959).

⁸⁷ Rosevear, *Should Canada Have an Air Code?*, a paper presented at the Annual Meeting of the Air Law Section of the Canadian Bar Association, Quebec City, Sept. 1960.

⁸⁸ *Attorney General of Canada v. C.P.R. and C.N.R.*, 12 D.L.R. 2d 625, 627 (1958).

⁸⁹ *C.N.R. and C.P.R. v. Attorney General of Saskatchewan*, 1 D.L.R. 580, 585 (1948).

⁹⁰ Professor Rosevear also referred to the *Johanneson* case, the *Aeronautics* case and *A.-G. Ontario v. Canada Temperance Federation*.

aspects with respect to which a provincial legislature might deal but I am at loss to state what they might be.

Further authority with respect to the general power of Parliament to legislate for the peace, order and good government of Canada is found in *Pronto Uranium Mines, Ltd. and Algom Uranium Mines, Ltd. v. Ontario Labour Relations Board*.⁹¹ This judgment concerned a question of whether the enactment of the Atomic Energy Control Act, R.S.C. 1952, Chapter 11, as amended, and Regulations thereunder, was valid legislation for the peace, order and good government of Canada. McLennan, J., delivered the judgment of the Court:

In this day it cannot be said that the control of atomic energy is merely of local or provincial concern, and in my opinion it is a matter which from its inherent nature is of concern to the nation as a whole and the Act and the Regulations are within the powers of Parliament to make laws for the peace, order and good government of Canada.

If I am correct in this conclusion, then the production of raw materials for developing atomic energy is a work, undertaking or business within the legislative authority of the Parliament of Canada, and Part I of the Industrial Relations and Disputes Investigation Act applies in respect of employees who are "employed upon or in connection with . . . (such) work, undertaking or business."

To paraphrase the language of Rand, J., in *Reference Re Validity of Industrial Relations and Disputes Investigation Act*, (1955), 3 D.L.R. 721 at pp. 746-7, S.C.R. 529 at p. 554, it would be incompatible with the power of Parliament to legislate with respect to the control of atomic energy for the peace, order and good government of Canada if labour relations in the production of atomic energy did not lie within the regulation of Parliament.

It is submitted that the constitutional cases to which reference is made above are authority for the opinion that the Parliament of Canada has exclusive jurisdiction to establish a central aircraft registry in order to record title to and all encumbrances against Canadian civil aircraft.⁹²

C. Bill No. C-37

On November 22, 1960, Mr. John Drysdale, Member of Parliament for Burnaby-Richmond, introduced in the House of Commons for its first reading Bill No. C-37, an Act to amend the Aeronautics Act. The object of the Bill was declared to be the provision of a central Canadian aircraft registry in order to record title to and all encumbrances against Canadian civil aircraft. The introduction of the Bill by a private member represented the first positive legislative step taken, notwithstanding the fact that the Canadian Bar Association had urged the Government of Canada to introduce enabling legislation for the establishment of such a registry every year since 1956. The Bill was moved for its second reading on June 30,

⁹¹ [1956] Ont. 862, 5 D.L.R. 2d 342 (1956).

⁹² It will be of interest to readers not familiar with the constitution of Canada to note that the Federal Government cannot enact laws to bring into effect the provisions of an international treaty or Convention which relates in substance to a class of subjects assigned exclusively to the provinces under the British North America Act. For the purposes of the distribution of legislative powers between the Dominion and the provinces under Sections 91 and 92, there is no such thing as treaty legislation as such. The distribution of powers is based on classes of subjects and as a treaty deals with a particular class of subject so would the legislative power of performing it be ascertained. *Refer to A.-G. Canada v. A.-G. Ontario*, (1937) A.C. 326 (Can.).

1961, by Mr. Drysdale who asked for support in principle for the amendment. Although support for the legislation was not then to be found due chiefly to a lack of understanding of its purpose, this important matter should be revived and the legislation studied further in accordance with the following resolution of the 1962 Annual Meeting of the Quebec Branch of the Canadian Bar Association:

Now, therefore, the Quebec Branch recommends that the Council of the Canadian Bar Association inform the Minister of Justice of its continued interest in the principle underlying Bill C-37 and suggest to the minister that the said Bill C-37 be referred to the appropriate committee of the House of Commons for further study and report and that the said committee be authorized to request interested persons and organizations to appear before it for the purpose of providing such information relating to the subject matter of the said bill as the committee may deem desirable or necessary.

After such further study and revision, the subject matter of Bill C-37 could then be reintroduced in the House of Commons under Government sponsorship. It is highly desirable that action in this regard be taken as soon as possible.

The provisions of Bill C-37 follow closely the provisions of comparable United States legislation contained in the Federal Aviation Act of 1958.⁹³ Having regard to the fact that the central aircraft registry in the United States has operated successfully since 1938, it is not unreasonable to select the United States legislation establishing such registry as a guide and point of departure for Canadian legislation.

The following are offered by way of general observations on the text of Bill C-37 in the hope that such observations will be helpful to those to whom the Bill is referred for further study:

(1) An object of the Bill is presumed to be to make the recording of rights in aircraft compulsory and to establish the requirement of recording as a condition precedent to the effectivity of any conveyance or instrument involving rights in aircraft. However, it is surely intended that once the requirement of recording has been compiled with, the substantive laws of the appropriate province or territory will in all respects govern such conveyance or instrument. For example, such substantive laws would determine the validity of rights so vested and liabilities so incurred, including the matter of the seniority *inter se* of liens and other security interests. If it be agreed that such a distinction can be drawn between effectivity and validity in these circumstances, it is recommended that the word "effective" be substituted for the word "valid" where the latter word occurs in the following extracts from subsections (3) and (4) of Section 26 of the Bill:

(3) No conveyance or instrument the recording of which is provided for by subsection (1) of this section shall be *valid* in respect of such aircraft, . . .

(4) Each conveyance or other instrument recorded by means of or under the system provided for in subsection (1) or (2) of this section shall from the time of its filing for recordation be *valid* as to all persons without further or other recordation.

In order to ensure that conveyances and instruments entered into prior to the date on which the amendment to the Act is to take effect, shall

⁹³ 72 Stat. 731, 49 U.S.C. §§ 1301-1542 (1958).

not be thereby affected, the phrase "entered into on or after (enter here appropriate date) and," should be inserted immediately after the word "instrument" where the latter word occurs in the above extracts from subsections (3) and (4) of Section 26.

(2) Section 27 of the Bill should be deleted in its entirety since it refers to registration of aircraft as distinct from recordation of rights therein. The matter of registration is covered in Part II of Air Regulations P.C. 1960-1775. Section 27 appears to have been transposed in error from Section 501 of the Federal Aviation Act of 1958 without taking into account the fact that the subject of registration has been handled by regulation in Canada.

In this connection, Section 25 (g) of the Bill should be amended to refer to "aircraft registered in accordance with regulations prescribed by the Minister."

(3) Paragraph (b) of subsection (1) of Section 26 has been drafted to include all engines and propellers whereas the comparable provision contained in Section 503(a) (2) of the Federal Aviation Act makes reference only to engines over seven hundred and fifty or more rated take-off horsepower. The increased protection afforded by the changes to paragraph (b) may not be worthwhile when balanced against the increased administrative burden placed upon the recording system. In paragraphs (b) and (c) of subsection (1) of Section 26, express reference to "equipment trust" has been deleted for no apparent reason although an equipment trust would still come within the meaning of the phrase "other instrument executed for security purposes."

(4) Paragraph (c) of subsection (1) of Section 26 imports into Canadian law the so-called basket lien amendment to Section 503 of the Civil Aeronautics Act which was enacted by Congress in 1948. Reference should be made to Chapter IV, Section C of Part I, for a discussion of the merits of this provision affecting spare parts.

V. CONCLUSIONS AND RECOMMENDATIONS

It appears at present that the year 1963 will be profitable, in terms of both earnings and equity appreciation, for a majority of United States airlines and their stockholders. The cost of servicing the debt incurred through the acquisition of new equipment remains a burden and the growth of passenger traffic is still disappointingly slow in comparison to the increases in capacity of the carriers, but the heavy initial expense of introducing the new type equipment into service has now been absorbed and these airlines are beginning to enjoy the operating economies of the jet era. While airline managements are boldly experimenting with new classes of service and promotional fares, they have not yet solved the problem of the steady increase in coach revenue passenger miles at the sacrifice of higher yield first-class passenger miles. A most promising new market of rapid growth is that of air cargo which, if properly exploited, should become a major source of revenue for the carriers in the future. In 1962, the "all-cargo" airlines carried a record 148,352,000 ton miles of freight representing a 21.6 per cent increase over the previous year.

A problem which will continue to confront air carriers in the United States and Canada is the relatively high cost of new equipment in comparison to earnings. Although the market values of many airline equities

have reached new highs during recent months, it may still be some time before the carriers can look to equity securities as a source of funds for aircraft purchases. The difficulties of financing the sub-sonic jets are only now being overcome and already the supersonic transport programme is well underway in Great Britain and France. It is apparent that the SST can only be made available to United States airlines by manufacturers in the United States if substantial government support can be found for its development.

In examining the legal problems of aircraft financing, it has been emphasized that the role of the law at this time must be to foster the development of a more favorable climate for investment by financial institutions.

In order to facilitate aircraft financing in Canada, the Canadian Government should introduce in Parliament as soon as possible legislation to establish a central registry for the recordation of title to and encumbrances against Canadian civil aircraft. The establishment of such central registry will enable Canada to ratify the Convention on the International Recognition of Rights in Aircraft which was signed in 1948. The protection afforded by the Convention will benefit financial institutions having property rights and security interests in flight equipment in use on international routes outside Canada.

In the United States, Congress should amend subdivision (5) of Section 116 of the Bankruptcy Act to extend the protection of subdivision (5) to the chattel mortgage. It has been seen that the chattel mortgage is, in many respects, the most suitable security device for use in aircraft financing and it would be unfortunate if the right of repossession by the chattel mortgagee should be in any way impaired by defective legislation. Also the proposal to introduce the floating charge in the United States as a security device available to airlines would warrant further study. The advantages of the floating charge both to airline managements and to investors commend this form of security.